UNITED NATIONS

DP

Executive Board of the United Nations Development Programme and of the United Nations Population Fund

Distr.
GENERAL

DP/1999/4
25 November 1998

ORIGINAL: ENGLISH

First regular session 1999
25-29 January 1999, New York
Item 6 of the provisional agenda
UNDP

SPECIAL FUNDS AND PROGRAMMES

# The Global Environment Facility, the Multilateral Fund for the Montreal Protocol programme, the Office to Combat Desertification and Drought and the United Nations Revolving Fund for Natural Resources Exploration

## Report of the Administrator

CONTENTS


| | Paragraphs | Page |
|---|---|---|
| INTRODUCTION | 1 - 7 | 3 |
| I. GLOBAL ENVIRONMENT FACILITY | 8 - 23 | 4 |
| A. Recent programme developments | 8 - 12 | 4 |
| B. Programme resources: approved allocations of projects | 13 - 14 | 5 |
| C. Results and impact | 15 - 23 | 6 |
| II. MONTREAL PROTOCOL PROGRAMME FOR THE PROTECTION OF THE GLOBAL OZONE LAYER | 24 - 32 | 8 |
| A. Recent programme developments | 24 - 27 | 8 |
| B. Programme resources | 28 - 30 | 8 |
| C. Results and impact | 31 - 32 | 15 |


98-37350 (E) 091298

CONTENTS (continued)


| | | Paragraphs | Page |
|---|---|---|---|
| III. | OFFICE TO COMBAT DESERTIFICATION AND DROUGHT ..... | 33 - 45 | 17 |
| | A. Recent programme developments ..... | 33 - 35 | 17 |
| | B. Programme resources ..... | 36 - 38 | 19 |
| | C. Results and impact ..... | 39 - 45 | 20 |
| IV. | UNITED NATIONS REVOLVING FUND FOR NATURAL RESOURCES EXPLORATION ..... | 46 - 54 | 22 |
| | A. Recent programme developments ..... | 46 - 48 | 22 |
| | B. Programme resources ..... | 49 - 50 | 23 |
| | C. Results and impact ..... | 51 - 54 | 24 |
| V. | COMMON ISSUES ..... | 55 - 60 | 24 |

## INTRODUCTION

1. The present report covers the activities of the Global Environment Facility (GEF), the Multilateral Fund for the Montreal Protocol programme, the Office to Combat Desertification and Drought (UNSO) and the United Nations Revolving Fund for Natural Resources Exploration (UNRFNRE), with a final chapter on common issues. UNSO and UNRFNRE were established by the General Assembly and are administered by UNDP; GEF and the Montreal Protocol were established and are governed by separate external mechanisms with UNDP playing the role of implementing agency.

2. All environmentally related units and offices at UNDP headquarters, including those responsible for trust-funded programmes or other funding mechanisms, are located in the Sustainable Energy and Environment Division (SEED) of the Bureau for Development Policy (BDP). SEED was established in 1994 to strengthen significantly UNDP capacity to implement programmes to spearhead the achievement of Agenda 21.

3. SEED work supports UNDP overall efforts to help developing countries to design and carry out successful programmes that integrate the protection and the regeneration of the environment with the use of natural resources to reduce poverty, generate sustainable livelihoods, and advance the status of women.

4. The Global Environment Facility is a financial mechanism providing grant and concessional funds to developing countries for projects and activities to protect the world's environment. Responsibility for implementing the GEF is shared by UNDP, the United Nations Environment Programme (UNEP) and the World Bank. UNDP is broadly responsible for capacity-building and technical cooperation activities and for managing the Small Grants Programme. As one of the three implementing agencies of the GEF, UNDP brings projects before the GEF Council for consideration and approval. While approval is granted externally, UNDP rules and regulations apply fully to the implementation of projects. The GEF funds activities that address climate change, biodiversity, ozone-layer depletion and international waters. Land degradation - primarily desertification and deforestation - is also eligible for funding as it relates to each focus area. A report on mainstreaming global environmental issues into UNDP activities was presented to the GEF Council in October 1998 (GEF/C.12/4).

5. The Montreal Protocol programme is concerned with remedying ozone-layer depletion and has two components. The larger component is the Multilateral Fund (MLF) for the Implementation of the Montreal Protocol, which was established in 1990 to assist developing countries to meet their incremental costs in eliminating ozone-depleting substances. It is funded by developed countries in recognition of their original responsibility - now shared by developing countries - for the ozone-depletion problem. UNDP is one of four implementing agencies under the MLF, the others being UNEP, the United Nations Industrial Development Organization (UNIDO) and the World Bank. Projects are developed according to specific guidelines and are then submitted to the Fund Secretariat for review and subsequently to the MLF Executive Committee for approval. The smaller component comprises UNDP activities to remedy ozone-layer depletion

under the GEF, which covers projects in the Commonwealth of Independent States, which are not eligible under Multilateral Fund criteria.

6. The Office to Combat Desertification and Drought is the central entity within UNDP responsible for spearheading and supporting UNDP efforts to meet the challenges to sustainable human development posed by desertification and drought in all affected programme countries. UNDP has taken a strong interest in the Convention to Combat Desertification (CCD), which has now been ratified by over 130 countries and has entered into full implementation. With the Administrator as overall Fund Manager, projects and activities are developed and approved within the UNDP framework.

7. The United Nations Revolving Fund for Natural Resource Exploration was established as a trust fund and placed in the charge of the Secretary-General in 1973. The Administrator administers the Fund on behalf of the Secretary-General. The Fund has made tangible contributions by discovering new mineral deposits in developing countries over the last 25 years. Responding to the changing world of the mining industry and the role of the United Nations, the Fund is redirecting its activities to become a catalyst for the sustainable development of mineral resources in developing countries. This includes giving due attention to environmental aspects of mineral resource exploration and mining, and shifting upstream from traditional exploration activities to policy and institutional-support activities and information services. The Fund will, thus, focus attention on activities that have a direct and more immediate impact on poverty alleviation, job generation and environmental protection.

## I. GLOBAL ENVIRONMENT FACILITY

### A. Recent programme developments

8. The 164 GEF member States that gathered at the first GEF Assembly in April 1998 agreed to a $2.75 billion replenishment, which will underwrite GEF operations until June 2002. The Assembly adopted the "New Delhi Statement", recognizing the unique role of the Facility and calling on it to accelerate its operations.

9. The GEF unit of UNDP has met its programming goals for each of the past three years and expects to do so again during fiscal year 1999, which began on 1 July 1998. The 260 full-sized GEF projects launched by UNDP since 1994 have mobilized over $600 million in GEF financing. Each project combines GEF funding with resources from Governments and other donors to enhance the capacities of people and institutions to utilize the information, knowledge, and technology needed to harmonize protection of the global environment with the development of healthy local economies.

10. At the national level, UNDP-GEF Enabling Activity projects in 138 countries are steadily building the capacities needed by developing countries to prepare national inventories, strategies and action plans in response to the United Nations Framework Convention on Climate Change and the Convention on Biological Diversity.

11. In line with the UNDP emphasis on cost-efficiency in the use of human resources, the Core Unit (including the Small Grants Programme) maintains nine professional staff and three long-term consultants. In addition, eight professional staff are outposted among the five regional bureaux serving as GEF regional coordinators. This level of staffing has remained the same for the past five years despite the continuing growth of the GEF work programme.

12. At the grass-roots level, the GEF Small Grants Programme, managed by UNDP, has built substantial local capacity and awareness in 46 different countries by funding over 1,000 projects since its inception. These small-scale endeavours respond simultaneously to the global environment and to the needs of local stakeholders. A recent independent evaluation found that the programme is often at the vanguard of building awareness of global environment issues, and recommended improvements in programme operations that led to a project document for a substantially expanded Small Grants Programme. This document was approved by the Council at its October 1998 meeting.

## B. Programme resources: Approved allocations of projects

13. Any differences in portfolio distribution among the regions reflect the GEF requirement that projects respond to country and demand-driven processes rather than to a preselected allocation of resources. The portfolio breakdown shown in table 1 is continually evolving. It could appear quite different after a single GEF Council meeting since each work programme approval can alter the portfolio's regional or focal area distribution by 30 per cent or more.

14. The new medium-sized initiatives category is expected to generate 25 projects, each with an average budget of $600,000, for a total of $15 million annually.

Table 1. UNDP-GEF portfolio as of September 1998[a]

(Millions of dollars)

| Region | Climate change | Bio-diversity | Inter-national waters | Ozone depletion | Multi-focal | Total |
|---|---|---|---|---|---|---|
| Africa | 30.8 | 88.7 | 17.4 | | | 136.9 |
| Asia and the Pacific | 96.1 | 54.3 | 26.2 | | | 176.6 |
| Arab States | 22.5 | 47.5 | 17.3 | | | 87.3 |
| Latin America and the Caribbean | 34.3 | 74.1 | 2.8 | 1.9[b] | 15.2 | 128.3 |
| Europe and the Commonwealth of Independent States | 12.8 | 1.0 | 31.4 | 13.0[c] | | 58.2 |
| Global | 20.2 | 3.2 | 3.5 | | 0.5 | 27.4 |
| Small Grants Programme | | | | | 39.0 | 39.0 |
| Total | 216.7 | 268.8 | 98.6 | 14.9 | 54.7 | 653.7 |

[a] Not including co-financing.

[b] Research activity not covered by the Montreal Protocol.

[c] Countries in this region are not covered by Article V of the Montreal Protocol and hence are funded by the GEF and not the Multilateral Fund. See chapter II.

## C. Results and impact

15. The entire UNDP-GEF portfolio is subject to the annual project implementation review (PIR) exercise, which identifies key lessons learned. This information is then published and distributed to all headquarters, country office, and project personnel active in GEF project development or implementation for the continual improvement of portfolio performance. Some of the key lessons learned to date from the PIR include the need to: secure realistic counterpart contributions; limit the number of primary objectives; establish clear responsibilities for project execution; train project staff in UNDP operational procedures at the outset of implementation; involve the private sector in project consultations and decision-making; and encourage policy development and regulatory structures that first address whole ecosystem rather than national or municipal boundaries.

16. While UNDP-GEF projects are producing success stories around the world on an ongoing basis, precisely quantifying the extent of their success is a relatively new endeavour. Several workshops in the logical framework methodology have been held at the country and regional levels to instruct future project executors on ways to integrate evaluation indicators into project design. All GEF projects presented to UNDP are now required to use the logframe approach from the outset of project development. This should result in an accurate quantification of project impacts.

17. The following brief review of a few projects in the UNDP-GEF portfolio indicates the success being realized at the country and regional levels.

18. The regional project Pollution Prevention and Management in the East Asian Seas highlights the challenge of water pollution that has confronted the global community during 1998, the International Year of the Ocean. The project helped formulate favourable and consistent government policies that are encouraging private-sector involvement in the provision of environmental infrastructure and services. With public consultation and scientific input throughout the region now legally defined, conflicts among users are typically being resolved in ways that promote the sustainable use of the marine environment. Regional and local marine pollution management frameworks have been established to monitor land and sea-based sources of pollution. Integrated coastal management with the participation of a wide diversity of stakeholders is being employed at two demonstration sites.

19. Biodiversity Conservation in the Choco Biogeographic Region is a multifaceted project addressing the unparalleled plant and bird biodiversity of Colombia's Pacific coast - a region that also has the highest poverty rate in the nation. An extensive consultative process led to execution being distributed among eight national and local NGOs; 27 Afro-Colombian grass-roots organizations; four Indigenous People's groups; six universities; and two scientific research organizations.

20. The China Coalbed Methane recovery project introduced cutting-edge technologies to China that reduce methane emissions while providing hands-on experience valuable to other coal abundant countries. Lessons learned in China are now being applied to a similar project in India, which is the third largest coal producer in the world.

21. The African Birdlife project is providing assistance to a largely self-sustaining initiative that relies on local volunteers to preserve and maintain diverse sites crucial to birdlife and biodiversity throughout the African continent. The initiative has led to a range of actions in partnership with local constituents, from simple boundary demarcation to long-term, site-based conservation projects.

22. In Jordan, Conservation of the Azraq Protected Area has restored one of the world's great oasis ecosystems from a state of serious decline caused by massive extraction of water from its aquifers. A Jordanian NGO, the Royal Society for the Conservation of Nature, utilized GEF resources to prepare a comprehensive water management plan and undertake emergency restoration efforts that have allowed the Azraq Oasis wetland ecosystem to flourish once again.

23. The Viet Nam Biodiversity Project achieved major successes in drafting a national biodiversity action plan for the country and improving protected area management capabilities. Over 1,000 professionals have been trained in collaboration with top international NGOs and university programmes. A related project in Viet Nam, Protected Areas for Resource Conservation, was approved in 1998 with $6 million from the GEF and $25 million from UNDP.

## II. MONTREAL PROTOCOL PROGRAMME FOR THE PROTECTION OF THE GLOBAL OZONE LAYER

### A. Recent programme developments

24. As of September 1998, UNDP was assisting 62 developing countries in all regions to eliminate the use of ozone-depleting substances (ODS) and reverse the damage to the global ozone layer. UNDP is cooperating in national country programme formulation, technical training, demonstration projects, national capacity-building, and technology transfer investment projects in the aerosols, foams, solvents, refrigeration, methyl bromide (fumigation) and fire-extinguishing sectors.

25. During 1991-1993, UNDP concentrated on providing technical cooperation and on assisting countries to develop their national Montreal Protocol country programmes. However, since 1994, based on requests from both countries and the Multilateral Fund (MLF) Executive Committee, UNDP has been concentrating on technology transfer conversion projects since over 80 per cent of the Fund's resources are earmarked for those activities. UNDP coordinates closely with the United Nations Industrial Development Organization (UNIDO) and the World Bank, with each agency making the maximum use of its comparative advantages. UNDP coordinates regularly with the United Nations Environment Programme (UNEP) by participating in and making presentations at UNEP-organized semi-annual network meetings of ODS government officers from eight subregions: French-speaking Africa; English-speaking Africa; West Asia; South-East Asia; South Asia; South America; Central America; and the Caribbean.

26. The Programme is managed by the Montreal Protocol Unit (MPU). The small staff of five professionals work with support staff and a number of sector and national experts. Institutional-strengthening and some technical cooperation programmes and investment projects are executed directly by Governments. UNDP country offices play a critical role in project and programme implementation.

27. The Programme contributes to two key UNDP goals: (a) the protection and regeneration of the environment and (b) the protection of jobs and livelihoods of those involved in small-scale operations whose businesses would become uncompetitive without this assistance.

### B. Programme resources

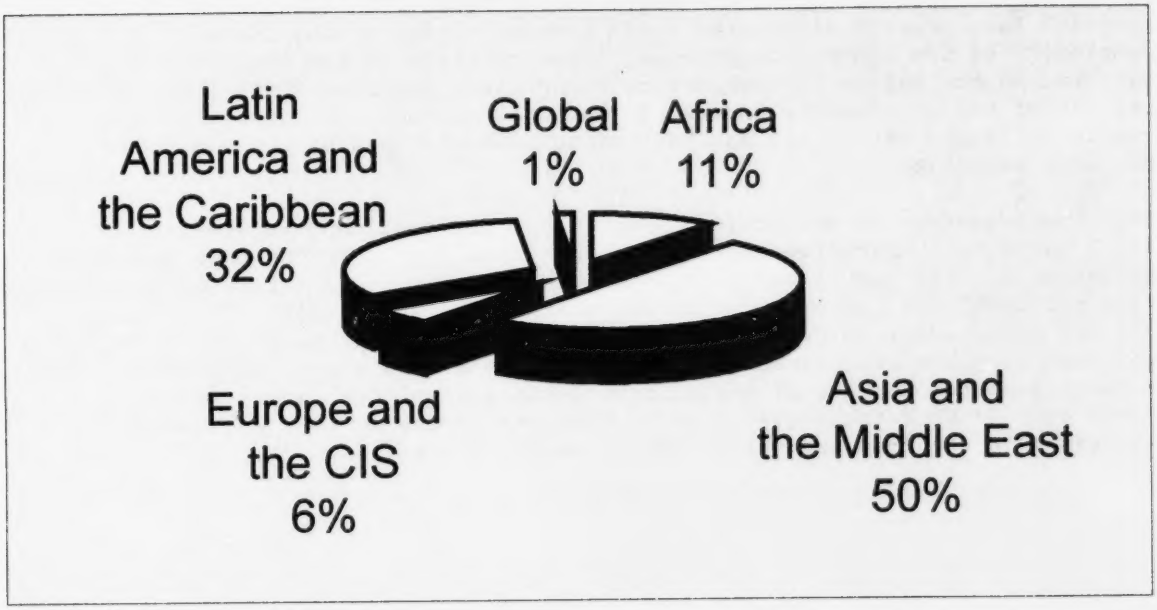
28. Total funding for the Multilateral Fund Programme has amounted so far to $1.29 billion: $240 million for 1991-1993; $510 million for 1994-1996, and $540 million for 1997-1999. About 80 per cent is normally collected, with

arrears mainly from countries in Eastern Europe and the Commonwealth of Independent States, who are experiencing severe economic difficulties. By August 1998, a total of $715.8 million had been allocated to eliminate 119,493 ODP tonnes (about one half of total consumption in developing countries).

29. The UNDP portfolio as of August 1998 comprises 800 projects with approved budgets of $215.76 million, of which $109.8 million (51 per cent) has already been disbursed. Of these project approvals, 94 per cent are under the Multilateral Fund and 6 per cent under the GEF. The UNDP programme will eliminate 27,346 ODP tonnes of ozone-depleting substances or about one quarter of the total approvals under the Multilateral Fund. Of this amount, UNDP projects have already eliminated 9,087 tonnes. Owing to the technical complexity of the conversion process, three quarters of the programme are executed by the United Nations Office for Project Services (UNOPS) at the request of the Governments concerned; national execution accounts for the remaining 25 per cent. All national capacity-building projects are under national execution.

30. The breakdown by sector is: foams (43.1 per cent) and refrigeration (38.3 per cent), which together account for four fifths of the UNDP programme; solvents (4.1 per cent); aerosols (3.1 per cent); halons for fire-extinguishing (1.6 per cent); and methyl bromide alternatives (0.4 per cent). The remaining 9.4 per cent covers technical cooperation, national capacity-building, training and demonstration programmes. In 1998, UNDP initiated a new programme to find alternatives for the use of methyl bromide in agriculture; approximately 5 per cent of UNDP funding will go to that new sector in 1999 with small decreases in the foam and refrigeration sector shares.

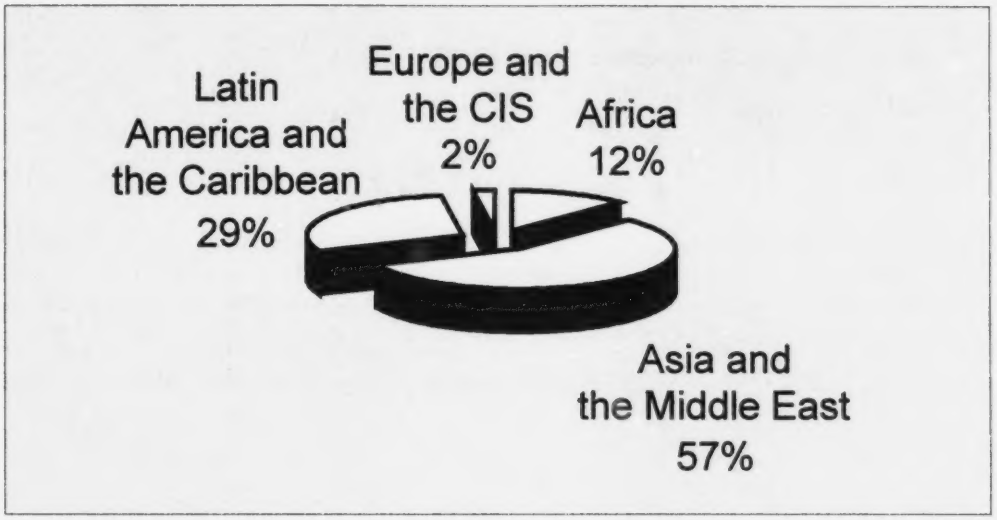
# Graph 1
# APPROVED PROJECT BUDGETS BY REGION
## (TOTAL: $215.8 Million)



# Graph 2

## ODP TONNES BY REGION

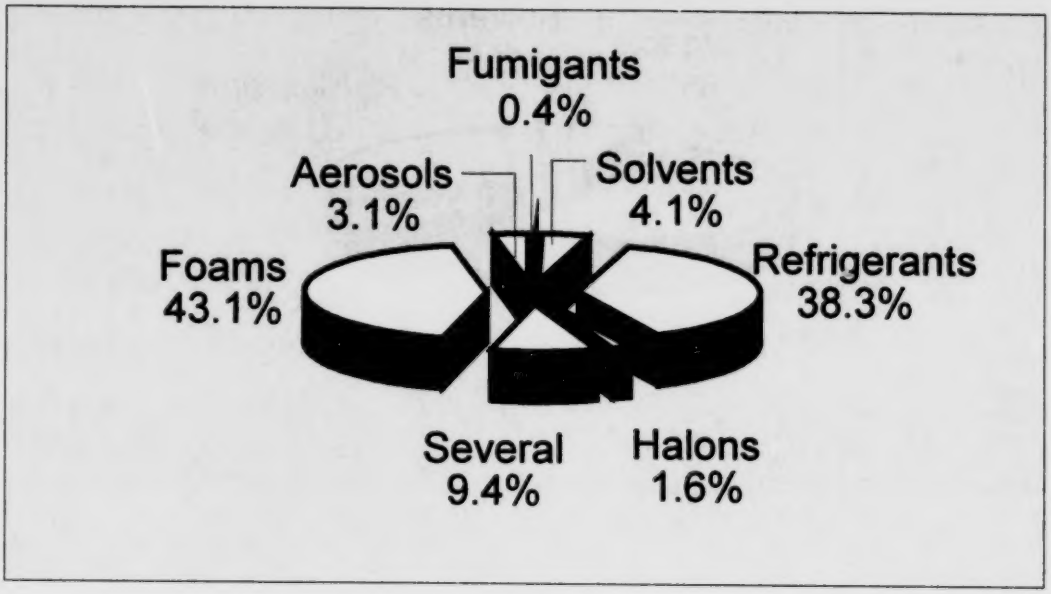
**(TOTAL: 27,346 ODP TONNES)**



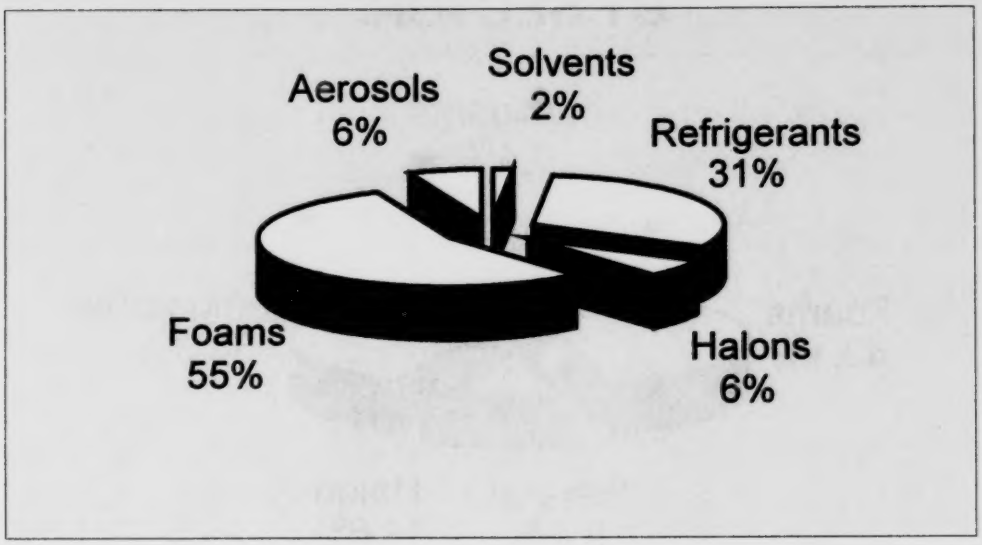
Regional shares of the UNDP cumulative programme are:

| | Percentage | Number of countries |
|---|---|---|
| Africa, including North Africa | 10.7 | 19 |
| Asia/Pacific, including West Asia | 49.7 | 14 |
| Latin America/Caribbean | 32.5 | 20 |
| Commonwealth of Independent States | 5.7 | 9 |
| Global programme | 1.4 | |

# Graph 3
# APPROVED PROJECT BUDGETS BY SECTOR



# Graph 4
# ODP TONNES BY SECTOR



## C. Results and impact

31. The Montreal Protocol has proved to be a flexible regime, evolving over time in response to new developments in science and technology. It has been used as a model for other international environmental agreements. The flexibility built into the Protocol in the form of its review process for targets and amendments has allowed continuous evolution to respond to changes in both scientific evidence and technological developments. The limits on supply imposed by the control schedules have encouraged the rapid development of cost-effective alternatives, which in turn have helped to reduce demand. The growth in concentrations of ODS chemicals in the stratosphere has slowed and if the Montreal Protocol control regimes are fully implemented, global ozone levels should gradually recover after the year 2000 with the Antarctic ozone hole finally closing around 2050. The evolving phase-out schedules and trade provisions have encouraged developing countries to move faster than required and eliminate ODS-using technologies. The next three-year replenishment of the Multilateral Fund will take place in late-1999 and further replenishments are expected until 2010.

32. The results of UNDP activities include:

(a) Montreal Protocol country programmes. Thirteen programmes, valued at almost $5 billion, were prepared with UNDP cooperation and approved by the Executive Committee: Bangladesh, China, Costa Rica, Cuba, India, Indonesia, Iran (Islamic Republic of), Kenya, Philippines, Sri Lanka, Trinidad and Tobago, Uruguay and Venezuela - amounting in total to almost $5 billion. Country programmes contain the framework under which individual conversion projects are designed, approved and implemented;

(b) Project completions. As of September 1998, UNDP completed 350 projects of the total 800 approved. Of this number, UNDP completed a total of 165 technology transfer conversion projects in 22 countries, eliminating a total of 9,087 ODP tonnes/year. The remaining balance of 185 completed projects comprise training, technical cooperation, project preparation and demonstration projects, as well as assistance provided in Montreal Protocol country programme preparation.

(c) Project impact. These 165 completed technology conversion projects have resulted in the following:

(i) Twelve foam projects in 12 countries have eliminated CFCs used as blowing agents in the production of flexible foam (e.g., mattresses, seat cushions), rigid foam (e.g., thermos flasks, refrigerator panels, pipe insulation, cold storage rooms), integral skin foam (e.g., moulded plastic furniture) and polystyrene foam (e.g., styrofoam containers);

(ii) Thirty-four refrigeration projects in 13 countries have eliminated CFCs used for cooling in the production of refrigerators, ice boxes and cold storage displays;

(iii) Twelve solvent sector projects in 4 countries that have eliminated ozone-depleting chemicals used for cleaning of radios, TV picture tubes, computer circuit boards, car bumpers, and other metal cleaning;

(iv) Four aerosol projects in 4 countries that have replaced CFCs used as aerosol propellants in hairsprays, deodorant cans, perfumes and other uses;

(v) Three halon projects in 2 countries that have replaced halons used in portable fire extinguishers and in building and airport fire protection systems with alternatives that do not destroy the ozone layer;

(d) Private sector involvement. UNDP has 479 conversion projects amounting to $175 million, most of which are private sector enterprises, thus making the Montreal Protocol programme the largest UNDP involvement with the private sector;

(e) UNDP leadership. UNDP completed the first 10 conversion projects under the Multilateral Fund; UNDP also completed the first conversion projects in Brazil, China, Egypt, Guatemala, India, Jamaica, Malaysia, Mauritius, Mexico, Morocco, Panama, Philippines, Sri Lanka and Uruguay;

(f) National capacity-building. UNDP has 21 ongoing institutional-strengthening projects that are developing governmental capacity to direct and monitor national efforts to meet the ODS elimination provisions of the Montreal Protocol. These 21 projects in Argentina, Bangladesh, Brazil, China, Colombia, Costa Rica, Cuba, Ghana, India, Indonesia, Iran (Islamic Republic of), Kenya, Malaysia, Mexico, Nigeria, Pakistan, Sri Lanka, Thailand, Trinidad and Tobago, Uruguay and Venezuela, have budgets amounting to $9 million, of which $4.9 million has already been disbursed;

(g) Small countries. Although recognizing the higher costs involved, UNDP had programmes in 29 low-ODS consuming countries, primarily in Africa and Latin America and the Caribbean. This ensures that smaller countries are not left at a competitive disadvantage;

(h) Bilateral programmes. At the request of the Governments of Australia, Denmark, Germany, Sweden and the United States, UNDP is implementing selected bilateral programmes for ozone-layer protection. These programmes are ongoing and amount to $1.77 million;

(i) Innovative approaches for small-scale enterprises. UNDP developed, and the Executive Committee approved, eight innovative approaches to eliminate ODS consumption in small and medium-sized enterprises (SMEs): umbrella projects in Brazil, Egypt, Guatemala, India, Malaysia, Mexico, Paraguay, and the Philippines. These SMEs often comprise critical sectors in many developing countries, accounting proportionately and in total for more employees than in larger companies. The innovation comprises the design and implementation approach for such projects - discounts on bulk purchases, technology transfer mainly by national experts, and adaptation of technology to small enterprise

needs. This process helps to ensure sustainable livelihoods by helping prevent small enterprise bankruptcies during the conversion process;

(j) Recognition of UNDP achievements. The MPU staff received Certificates of Meritorious Service for the Protection of the Ozone Layer, presented by the UNEP Executive Director in September 1997 at the tenth anniversary of the adoption of the Montreal Protocol in Montreal. UNDP/Manila received a United States Environmental Protection Agency award in November 1997 in recognition of its leadership in protecting the earth's ozone layer, with specific reference to a solvents sector programme that channelled private sector expertise to help small and medium-scale enterprises to convert to non-CFCs. Teamwork played a critical role in the success of the programme.

## III. OFFICE TO COMBAT DESERTIFICATION AND DROUGHT

### A. Recent programme developments

33. In accordance with Executive Board decision 95/6, the United Nations Sudano-Sahelian Office, established by the General Assembly in 1973, was renamed the Office to Combat Desertification and Drought, while keeping the acronym UNSO. The work of the Office was refocused in three ways:

(a) Geographic expansion from the Sudano-Sahelian zone to the whole of Africa, Latin America and the Caribbean, Asia, the Commonwealth of Independent States and Arab States;

(b) Move from downstream project activities to upstream policy and institutional support in the context of the implementation of the Convention;

(c) Integration into UNDP as the unit responsible for leading the organization's work in desertification control and dryland management in all affected regions.

34. In the light of the change of mandate reflected above, UNSO work has been reorganized and a number of programmes and corresponding sets of activities have been developed to support the implementation of the International Convention to Combat Desertification in Countries Experiencing Serious Drought and/or Desertification (CCD) at national, subregional and global levels.

35. Since 1995, some 49 countries have received catalytic financial assistance and technical cooperation from UNSO to support CCD implementation (see table 2).

Table 2. Countries receiving technical support and catalytic financial support from UNDP/UNSO in the context of the CCD

| Africa (23 countries) | Arab States (7 countries) | Commonwealth of Independent States (5 countries) | Latin America and the Caribbean (12 countries) | Asia and the Pacific (2 countries) |
|---|---|---|---|---|
| Benin | Djibouti | Kazakhstan | Argentina | China |
| Botswana | Jordan* | Kyrgyzstan | Bolivia | Mongolia |
| Burkina Faso | Lebanon | Tajikistan | Brazil | |
| Cameroon | Morocco | Turkmenistan | Chile | |
| Cape Verde | Sudan | Uzbekistan | Dominican Republic | |
| Chad | Syria | | Ecuador | |
| Eritrea | Tunisia* | | Haiti | |
| Ethiopia | | | Honduras | |
| Gambia | | | Mexico* | |
| Ghana | | | Nicaragua | |
| Kenya | | | Paraguay | |
| Malawi | | | Peru | |
| Mali | | | | |
| Mauritania | | | | |
| Mozambique | | | | |
| Niger | | | | |
| Senegal | | | | |
| Swaziland | | | | |
| Tanzania | | | | |
| Togo | | | | |
| Uganda | | | | |
| Zambia | | | | |
| Zimbabwe | | | | |

* No catalytic financial support.

## B. Programme resources

36. UNSO is managing the Trust Fund to Combat Desertification and Drought, established by the Administrator in 1995 to complement core resources with a view to enhancing UNDP support to the implementation of the CCD world-wide. Total contributions to date amount to $14.5 million (table 3). Pursuant to the General Assembly resolution on Urgent Action for Africa, the bulk of support has gone to this region.

37. From its previous mandate, UNSO has continued to backstop a sizeable project portfolio amounting to a total volume of some $19 million. Most of the projects are operationally closed with 14 to be completed during the next few years. In the future, activities at the local level will be supported in the programmatic framework of the national action programme (NAP) process.

38. During the reporting period, the Office went through a significant down-sizing of some 50 per cent: from 25 to 12 professional staff. UNSO maintains two technical support projects, in Kenya and Burkina Faso, to ensure timely and close technical backstopping to the affected countries and to subregional efforts. Similar arrangements are being considered for the other regions.

Table 3. Contributions to the Trust Fund to Combat Desertification and Drought (1995-1998)

| | $ |
|---|---|
| Australia | 868 297 |
| Benin | 3 000 |
| Burkina Faso | 3 350 |
| Denmark | 4 814 156 |
| Finland | 1 579 785 |
| France | 500 000 |
| Ghana | 10 000 |
| Inter-American Development Bank | 65 327 |
| Italy | 92 308 |
| Lesotho | 1 574 |
| Luxembourg | 591 000 |
| Monaco | 12 659 |
| Namibia | 1 500 |
| Netherlands | 941 565 |
| Norway | 3 672 728 |
| Portugal | 25 000 |
| South Africa | 5 000 |
| Sweden | 924 245 |
| Switzerland | 401 374 |
| United States | 36 700 |
| Zambia | 1 000 |
| Zimbabwe | 501 |
| Others | 4 |
| Total | 14 551 073 |

## C. Results and impact

39. With support from UNSO, 49 countries have been able to launch the implementation of the Convention and 11 have held their first stakeholder forum meetings. Many have integrated the NAP process with other strategic frameworks and have defined and strengthened institutional support mechanisms. National focal points (NFP) for the Convention have been strengthened, particularly in their ability to manage multi-stakeholder planning processes. Countries have thus been able to initiate functional partnerships between Governments, civil society and external partners. Priority programmes focusing on efforts to combat desertification and drought at local levels are being developed.

40. Support to NAP processes focuses on policy and institutional development, including sharing of conceptual approaches, resource and advocacy materials, and training. About 20 per cent of funds allocated by UNSO to support NAP activities serve to strengthen effective participation of non-governmental and community-based organizations. In addition to continued technical backstopping at the country level, UNSO, with various partners, has organized capacity-building workshops for national CCD focal points, UNDP Sustainable Development Advisers and NGOs at the regional level for 25 African countries, 15 countries in Western Asia, 8 countries in Central Asia, and several in the Latin America and Caribbean region. National United Nations Volunteers have been placed in 13 countries in Africa. This initial support has laid the ground for dealing effectively with desertification and drought in the long run.

41. Pilot programmes and thematic initiatives have been developed and supported, particularly at the national level as complementary elements in the respective NAP processes:

(a) National desertification funds respond to the need to mobilize and channel resources effectively to support local activities. The design phase has been initiated in 32 countries; some countries are close to establishing the fund. The funds will strengthen access of local communities to financial resources to support priority activities in combating desertification;

(b) Drought preparedness and mitigation (DPM) programmes, which aim to strengthen national and local planning and drought response capacities are being piloted so far in El Salvador, Mozambique and Swaziland and through subregional drought mitigation strategies in Southern and Eastern Africa. An assessment of the status of DPM in sub-Saharan Africa has been completed, providing a basis for strengthening country capacities;

(c) Environmental information systems have been established to provide reliable data for decision making. Cape Verde, Eritrea, Gambia, Mali, Niger, Senegal, the United Republic of Tanzania and, more recently, China have received direct support, including support to resolve cross-sectoral data issues, increased awareness and institution-building for information management;

(d) Community-based pilot programmes to support local initiatives aimed at promoting access to small grant resources for priority actions have been launched in Eritrea, Kenya, Lesotho, Malawi, Sudan, Swaziland, Uganda, United Republic of Tanzania and Zimbabwe;

(e) The transfer of local knowledge through farmer innovators has been the focus of a pilot programme in Kenya, Uganda and the United Republic of Tanzania: Promoting Farmer Innovation in Rain-fed Agriculture. At least 50 per cent of the farmers benefiting from the programme are women;

(f) Four technical consultations on pastoral development, facilitated by UNSO, have advanced knowledge for promoting programme components in the context of action programmes.

42. Concept development for the implementation of the CCD has been a significant component of UNSO guidance in all of the above programmes for action at both the country and subregional levels.

43. At the subregional level, support has been provided for the subregional action programme processes. In Africa, the four subregional institutions (the Intergovernmental Authority for Drought and Development, the Permanent Inter-State Committee on Drought Control in the Sahel, the South African Development Community, and the Arab Maghreb Union) are leading the process. In Latin America, the countries in the Gran Chaco Americano and Puna regions cooperate on issues regarding shared ecosystems. Priority programme areas and funding sources and mechanisms are being identified and arrangements for coordination and exchange of information put in place. This has helped to address the management of transboundary resources, networking and sharing of experiences and learning and other issues.

44. Global initiatives support the implementation of the Convention at all levels:

(a) The Global Mechanism has been established to promote resource mobilization for the CCD. While the mechanism is being housed within the International Fund for Agricultural Development (IFAD), the First Conference of Parties (COP I) conferred two major roles on UNDP: (i) designation of Managing Director of the Global Mechanism and (ii) substantively buttressing the work of the Global Mechanism in a collaborative institutional arrangement involving IFAD and the World Bank. The Facilitation Committee for coordinating the support of UNDP, IFAD, and the World Bank to the Global Mechanism is now in place. UNDP hosted the second meeting of the Facilitation Committee in July, at which time it was decided to expand membership of the Committee to include four regional development banks, the GEF secretariat and the Managing Director of the Global Mechanism;

(b) UNSO has been able to contribute in raising awareness and building commitment through a strong advocacy role in various forums; emphasis on advancing and sharing knowledge; targeted distribution of information notes, advocacy kits, visual and resource materials; and the sponsoring of special events such as those in the context of World Day to Combat Desertification;

(c) A strong emphasis has been placed on partnership-building and effective participation. A strategy and 12-month plan of action to strengthen the role of women in the implementation of the CCD on all levels was developed in collaboration with the International NGO Network on Desertification.

Technical and financial support is provided to strengthen NGO networking, and for organizing national, subregional, regional and global RIOD meetings;

(d) In collaboration with UNEP, UNSO is assisting in a survey and evaluation of existing networks and institutions working on desertification for the Committee on Science and Technology, as requested by COP I. In addition, a matrix of indicators and a methodology on benchmarks and indicators to assess the implementation of the Convention is being developed with the CCD secretariat, the Sahara/Sahel Observatory and others.

45. Several overall challenges are being faced:

(a) As a country-driven process, the implementation of the CCD varies from country to country, and this has affected the pace of delivery of UNSO support to the affected countries. This problem is being addressed by locating technical resources closer to the regions, e.g., in Burkina Faso and Kenya;

(b) Resources to the Trust Fund have not increased sufficiently to expand support to regions other than Africa at the needed and desired level. Donors have not yet responded fully to the new role and global mandate of UNSO;

(c) There is a need to develop new and appropriate approaches to fit the conditions of the new regions. Despite this, support to Latin America and the Caribbean, Asia, the Commonwealth of Independent States and the Arab States has increased.

## IV. UNITED NATIONS REVOLVING FUND FOR NATURAL RESOURCES EXPLORATION

### A. Recent programme developments

46. There has been a considerable change in the mining industry over the last 30 years. As the mining industry changes, so must the United Nations institutions change in delivering technical cooperation and advisory services within the mining sector. It has become apparent that multidisciplinary technical solutions are called for to foster sustainable human development. At the same time, there is now a growing recognition that a focus on environmental issues relating to mining is essential for sustainable development. UNRFNRE is, therefore, redirecting its activities to focus on addressing environmental issues relating to the mining sector.

47. At present, the Fund is seeking more diversified activities under the concept of sustainable development. For this purpose, the Fund is aiming to:

(a) Shift from activities of pure mineral exploration to promote a multidisciplinary technical cooperation approach to national resource development;

(b) Shift from traditional high-cost exploration activities to low-cost activities with high impact in UNDP focus areas, including broader contributions to the environment in developing countries;

(c) Promote partnerships with external organizations to reduce project expenditures;

(d) Promote cross-cutting activities within the focus areas of UNDP.

48. This new direction will include activities to complement the UNDP spectrum of natural resource interventions. Consistent with the UNDP corporate goal, the Fund perceives a niche in which it can utilize its resources to make strategic interventions in the minerals sector while furthering the goals of poverty eradication, job creation and environmental protection. In October 1998, the Fund held a workshop in New York on the sustainable development of non-renewable natural resources towards the twenty-first century. The aim of the workshop was to demonstrate the evolving and expanding mission of the United Nations in the fields of non-renewable natural resources, to share information and to establish a vertical and horizontal network to facilitate future partnerships among external organizations.

## B. Programme resources

49. UNRFNRE project expenditures amounted to 0.611 million for 1997. The voluntary contributions for 1997 amounted to 0.133 million, representing a sharp decrease from 1.339 million for 1996, owing to the receipt of a major donor's remittance of its 1997 contribution (1.0 million) only in 1998. The financial picture of the Fund is presented in table 4.

50. Recognizing the size of its financial resources, the Fund will allocate resources to those requests which, with limited resources, can have a direct and more immediate impact on poverty reduction, job generation and environmental protection. Priority will be given primarily to activities in the mineral sector that relate to environmental issues, consistent with the UNDP focus areas.

Table 4: Resource availability and utilization: UNRFNRE

(In millions of US dollars)

| | Actual 1997 | Estimated 1998 |
|---|---|---|
| Resources available | | |
| Opening balance as of 1 January | 3.97 | 3.14 |
| Additional resources received | | |
| Voluntary contributions | 0.13 | 1.69 |
| Interest and other income | 0.21 | 0.20 |
| Total | 4.31 | 5.03 |
| Use of resources | 1.53 | 1.95 |
| Resource balance as of 31 December | 2.78 | 3.08 |

### C. Results and impact

51. With a portfolio of economic mineral discoveries (Bolivia, Guatemala, Honduras, Peru, Philippines and the United Republic of Tanzania) that can be put into production in the future, the Fund continued to monitor the actions taken by the private mining companies towards bringing these discoveries into production. The mining right of gold deposits in Peru discovered by the Fund was sold to a Brazilian company for $5 million. Production is expected to start in the near future. The Fund was successful in discovering a major gold deposit in the United Republic of Tanzania that is being investigated further by an international mining company. Production is expected in late 1999. The Fund continued to provide assistance to countries where discoveries were made in the form of legal advice and help in preparing international bidding documents aimed at stimulating interest of the private mining companies.

52. The current projects in Mozambique and Sri Lanka will contribute significantly to the recipient Governments. In 1997, a completed offshore project in Sri Lanka identified 400 million cubic metres of heavy mineral sands. In 1998, multidisciplinary technical cooperation has started in Mozambique. This pilot project is aimed at the recovery of a valuable mineral (tantalite) from old mining dumps in addition to reclamation activities and on-the-job training in order to resume the potential production of minerals by local people with minimal impact on the environment. The Fund also provided assistance to the Government of Suriname to evaluate an environmental impact assessment submitted by a private mining company for the development of a gold mine.

53. The Fund published four guidebooks in 1998 for environmentally sound mining activities in close collaboration with external organizations. These guidebooks were disseminated to more than 50 developing countries through UNDP country offices in order to share technology information. At the same time, through the United Kingdom-based firm, Mining Journal Books Limited the Fund has also made available on a commercial basis (CD-ROM) the mining legislative frameworks in Asian countries on a commercial basis to attract potential investors in the private sector.

54. The small-scale and artisanal mining sector is an entry point for the Fund to promote an integrated and multidisciplinary approach to natural resource management. The new direction of the Fund reflects the new challenges of linking to food security (small-scale mining of rock phosphates to improve soil fertility), water management (mercury abatement in Suriname) and sustainable livelihoods (artisanal and/or small-scale mining and community issues).

## V. COMMON ISSUES

55. The four trust-funded programmes, together with the other environmentally related trust-funded programmes such as Capacity 21, contribute important components to UNDP efforts to integrate environment and natural resource management into programming at the country level. As part of BDP, the trust-funded programmes contribute to the role of the Bureau in developing innovative processes and strategies, policy-making tools and the dissemination

of experiences that take account of both the need for poverty reduction and sound environmental management.

56. Mainstreaming. A common element in the trust-funded programmes is the great emphasis they place on mainstreaming their activities with country programmes as well as integrating the activities of each fund with those of other funds and programmes. For example, an increasing number of country cooperation frameworks (CCFs) indicate attention to dryland management and the implementation of the CCD. A recent study showed that some 23 per cent of 113 countries surveyed had included desertification-related components. UNDP core resources have been leveraged at country level for dryland activities, for example, in Brazil, Burkina Faso, Chad, China, Mali and the United Republic of Tanzania. UNSO has initiated close collaboration with the regional bureaux and programmes are being developed with other UNDP units, e.g., with SEPED on poverty reduction and livelihoods, the United Nations Development Fund for Women and the Gender-in-Development Programme on gender, and the Emergency Resource Division (ERD) on Drought Preparedness and Mitigation.

57. In order to provide advice on allocation of in-country resources, UNDP/GEF staff regularly attends meetings to review advisory notes, CCFs programme outlines and project documents. They also regularly review the project pipelines of each Regional Bureau in order to identify potential joint projects. As a result, several UNDP projects have been reoriented as a result of GEF participation. There is also very close collaboration between the GEF, the Energy Programme and country offices in the area of mitigating climate change and introducing new, alternative energy technology.

58. Close attention is also paid to the changes mandated in the UNDP 2001 process. In an effort to decentralize the expertise under the trust-funded programmes, staff and consultants have been placed in regional bureaux, in country offices and in regions in order to give technical support for project development and implementation close to the user. An important aspect of this effort is the sharing of lessons learned throughout the lifetime of the programmes.

59. Partnerships and resources. The trust-funded programmes have been a vital factor for resource mobilization, the building of partnerships and coordination of development activities with NGOs, civil society and United Nations specialized agencies. UNSO, for example, has forged partnerships with a wide range of organizations, including United Nations specialized agencies, subregional organizations, regional development banks, and multilateral and bilateral organizations and research institutions. The partnerships have helped concerned organizations to forge a common vision on how best to support the implementation of the CCD, to increase synergies and enhance the knowledge based on desertification issues. For the Montreal Protocol, NGOs have played an essential part in the international negotiations on ozone-layer protection. They monitor the implementation process of the Montreal Protocol, develop information campaigns to raise public awareness on ozone issues, and pressure Governments and industry to cut ODS production more quickly. The Small Grants Programme under the GEF has served as a model for involving NGOs and local community partners in programme development and implementation.

60. Capacity-building. Inherent in all trust-funded programmes is the commitment to build capacity and create an enabling environment encompassing technologies, policy dialogue, legislation and awareness. Through this, they contribute to the implementation of the mandate given to UNDP in Agenda 21. Following UNCED, Capacity 21 was established specifically to help UNDP to fulfil its mandate; its efforts are well complemented by those of the other trust-funded programmes. Under the Montreal Protocol, UNDP has 22 ongoing national institutional-strengthening projects in all regions, which are developing government capacity to direct and monitor national efforts to meet commitments under the Protocol. UNDP-GEF enabling activity projects are steadily building capacities in 138 countries to prepare national inventories, strategies and action plans in response to the United Nations Framework Convention for Climate Change and the Convention on Biological Diversity. UNDP also provides support to engage in international climate change negotiations. Each of the 260 UNDP-GEF projects strives to enhance in-country human capacity to utilize the information, knowledge and technology necessary to halt the degradation of the global environment.

---

**UNITED NATIONS**

**DP**

**Executive Board of the United Nations Development Programme and of the United Nations Population Fund**

Distr.
GENERAL

DP/1999/5
18 November 1998

ORIGINAL: ENGLISH

First regular session 1999
25-29 January 1999, New York
Item 8 of the provisional agenda

# UNDP FINANCIAL, BUDGETARY AND ADMINISTRATIVE MATTERS

## UNDP FINANCIAL RISK MANAGEMENT; REVIEW OF OPERATIONAL RESERVE

Report of the Administrator

SUMMARY

The present report provides an assessment of the financial risks faced by the United Nations Development Programme. It includes a summary of the history of the Operational Reserve and presents a review of financial management concepts, including liquidity, working capital and the level of reserves as they pertain to UNDP operations. Finally, the report includes recommendations as to the appropriate levels of liquidity, working capital and reserves that should be maintained under regular and other resources.

The Executive Board may wish to: (a) take note of the report of the Administrator; (b) note the recommended approach to the determination of UNDP liquidity; (c) support the recommendation of the Administrator for the establishment of a reserve for Other Resources activities and the mechanism for its funding; (d) note the recommended formula for the calculation of the UNDP Operational Reserve and the intention of the Administrator to include it in the Financial Rules.

98-35993 (E) 101298

CONTENTS


| | | Paragraphs | Page |
|---|---|---|---|
| I. | INTRODUCTION | 1 - 2 | 3 |
| II. | REVIEW OF THE OPERATIONAL RESERVE | 3 - 9 | 3 |
| III. | FINANCIAL MANAGEMENT CONCEPTS | 10 - 16 | 5 |
| IV. | UNDP RISK ASSESSMENT | 17 - 27 | 6 |
| V. | APPLICATION OF FINANCIAL MANAGEMENT CONCEPTS | 28 - 52 | 8 |
| VI. | RECOMMENDED LIQUIDITY, WORKING CAPITAL AND RESERVE LEVELS | 53 - 54 | 15 |
| VII. | EXECUTIVE BOARD ACTION | 55 | 16 |

# I. INTRODUCTION

1. The present report contains a review of the Operational Reserve and an analysis of the nature of financial risks faced by UNDP. It also defines and discusses the concepts of risk management, liquidity, working capital, the Operational Reserve and other contingency reserves.

2. Terms used in the report to describe Regular Resources and Other Resources of UNDP are those defined in the harmonized budget format (DP/1997/2-E/ICEF/1997/AB/L.3) approved by the Executive Board in its decision 97/6.

# II. REVIEW OF THE OPERATIONAL RESERVE

3. The most important existing financial mechanism for UNDP risk management is the Operational Reserve. Established by the Governing Council in the annex to its decision 70/34,[1] the management objective of the Reserve was "... to guarantee under all circumstances the financial liquidity and integrity of the programme, to compensate for uneven cash flows and to meet such other requirements as may be decided upon by the Governing Council at a subsequent stage".

4. The Operational Reserve was created in conjunction with a shift in policy from full funding (i.e., projects undertaken only when funds for their completion were 100 per cent available) to partial funding, as approved by the General Assembly (resolution 2688 (XXV)). Under a partial funding system, UNDP is authorized to approve programme activities against anticipated income and in excess of cash on hand. A primary factor in the success of a partial-funding system is the ability to predict future contribution levels and delivery rates. This change in operating guidelines allowed UNDP to leverage its expected contributions and expand its programming activities. Funds allocated to the Operational Reserve were not intended to be programmed but were set aside to meet uneven cash flow requirements as they arose.

5. The Operational Reserve was initially established at the level of $150 million. At that time, the Reserve was composed of cash and illiquid investments ($90 million) and letters of credit ($60 million).

6. In 1975, UNDP experienced a financial crisis: expenditures exceeded contributions and the Operational Reserve was drawn down. Responding to the crisis, the Governing Council, in its decision 76/34 of 29 June 1976, decided that the level of the Operational Reserve should be built up during the second cycle to a minimum level of $15 million in 1977 and thereafter progressively built up each year to reach a fully funded liquid level of $150 million by the end of 1980.[2] The Council noted the report of the Administrator on the subject (DP/199), in which he recommended that the Operational Reserve should be held exclusively in liquid investments, rather than a combination of investments and letters of credit. The Administrator also noted in his report that UNDP had a clear requirement for working capital relating to the level of cash flows and separate from an Operational Reserve. In its decision 79/31 of 2 July 1979, the

Council approved an increase of the Reserve by $25 million in both 1980 and 1981, thus attaining a level of $200 million by the end of 1981.

7. In his report on the Operational Reserve (DP/469 and Corr.1 and Add.1) submitted to the Governing Council at its twenty-seventh session (1980), the Administrator completed an assessment of risk factors and related the size of the Reserve to the potential occurrence of risks. Risk factors included downward fluctuations or shortfalls in resources, uneven cash flows, increases in actual costs as compared to planning estimates or fluctuations in delivery, and other contingencies that result in a loss of resources for which UNDP has made commitments for programming. These factors are cited in Financial Regulation 12.2(a).

8. Taking into account the recommendations of the Administrator, which were based on an analysis of UNDP activities at the time, the Governing Council, in paragraph 3 of its decision 80/50 of 30 June 1980, decided that the elements to be compensated for and covered by it should be limited to:

(a) Downward fluctuations or shortfalls in resources; [14 per cent of anticipated annual pledges, as noted in document DP/469]

(b) Uneven cash flows; [12 per cent of anticipated annual pledges, as noted in document DP/469]

(c) Increase in actual costs or as compared to planning estimates or fluctuations in delivery;

(d) Other contingencies which result in a loss of resources for which UNDP has made commitments for programming. [4 per cent of anticipated annual pledges, as noted in document DP/469]

While the allocations equalled 30 per cent of anticipated annual pledges, it was considered unlikely that all contingencies would occur at the same time. Accordingly, in paragraph 4 of the same decision the Council established the level of the Operational Reserve for each year of the third programming cycle (1982-1986) of 25 per cent of the anticipated 25 per cent of the estimated contributions or expenditures for that year, whichever might be the higher.

9. In its decision 90/44 of 22 June 1990, the Governing Council noted the Administrator's comments on the Operational Reserve, recommending a modified formula by which the Reserve would be set at 20 per cent of expected annual contributions or expenditures, whichever was higher. The reduction in the percentage from 25 per cent to 20 per cent was based on the Administrator's recommendation that improved information systems and operating procedures made quick response to adverse financial circumstances easier. Based on this formula, the Operational Reserve was set at $200 million in 1997. Should the formula be retained, it is calculated at a level of $180 million in 1998 and 1999 based on the forecast presented to the Board in the annual review of the financial situation, 1997 (DP/1998/29).

## III. FINANCIAL MANAGEMENT CONCEPTS

10. There are several generally accepted financial concepts that can be applied to manage current assets on the balance sheet of an organization. They include working capital and contingency reserves, which, taken together are generally referred to as liquidity. These concepts are based on a determination and management of the appropriate amount of current assets that must be held to ensure that the organization can meet its obligations in a way that minimizes uneven cash flows and provides financial stability. As noted in section II, the concepts of working capital and reserves were considered similar in nature and included together in early calculations of the size of the Operational Reserve. However, it is important to understand the differences between working capital, contingency reserves and liquidity.

11. Working capital smooths uneven cash flows. In the case of UNDP, working capital is used to provide advances to executing agents, fund unliquidated obligations and pay ongoing administrative expenses. Working capital is not set aside in the nature of a reserve. It is the residual of cash flows into and out of an organization. Working capital is part of resources available for programming. As specified in Financial Regulation 12.4, working capital is to be provided for from the cash resources of UNDP. UNDP has never formally articulated its requirements for working capital.

12. Contingency reserves are liquid assets that are set aside and available only to meet specified financial risks. Prudent financial management dictates that they are not fungible and not available for use as working capital or for programming. This is particularly true when an organization does not have borrowing authority. The Operational Reserve exists today as a contingency reserve for Regular resources activities. However, UNDP activities have changed substantially since the Operational Reserve was first established in 1971 and since the last modification to the formula was made in 1990.

13. Liquidity is defined as the sum of working capital and reserves at any point in time. From a balance sheet perspective, liquidity is the sum of cash and investments held. Liquidity levels fluctuate as assets are used and replenished in a cycle that provides both working capital for ongoing operations and for reserves.

14. The concept of fiduciary responsibility is fundamental to the role of UNDP as a trustee for the assets of other entities (e.g., trust funds, Governments). It is responsible for the management of working capital and reserves for Other resources activities (e.g., Funds administered by UNDP) and must ensure that proper segregation of assets is maintained. It is not appropriate, for example, for UNDP to use Other resources cash contributions to smooth uneven cash flows that may occur in Regular resources activities.

15. The most significant change in UNDP operations has been the growth in Other resources activities, particularly cost-sharing and trust funds. Over the past few years, Other resources activities have grown to represent a significant portion of UNDP activities. The annual review of the financial situation, 1997 (DP/1998/29) contains additional details on the subject.

16. By definition, the Operational Reserve is limited to providing reserves needed for Regular resources activities. Based on trends observed in the growth of Other resources activities, which, under the provision of the Financial Regulations and Rules, are required to be fully funded, the Administrator believes that a contingency reserve is needed for risks associated with these activities. The Operational Reserve, which is funded from Regular resources, should continue to be a reserve for risks associated solely with Regular resources activities.

## IV. UNDP RISK ASSESSMENT

17. Risk management is not a science but rather a blend of management judgment and practical experience. Proper risk management involves the identification of a risk and a prudent judgment about its likelihood of occurrence and any resulting financial implications. While the occurrence of certain contingencies may be deemed unlikely, their potential financial impact may be so great as to require inclusion in a prudent management response plan.

18. The following risk assessment is based on an analysis of the UNDP income statement and balance sheet. Risks can arise from income or expenditure-related activities and from the valuation of assets and liabilities. The process followed by UNDP to refine its knowledge and understanding of these financial risks has progressed in stages over the past two years.

19. As noted in paragraph 30 of document DP/1997/24, UNDP retained an international consulting firm in March 1997 to conduct an assessment of UNDP financial risk and comment on a prudent level of liquidity for UNDP. The review concluded that the current Operational Reserve formula no longer provides a reliable basis for addressing the risks identified. Based on the consultants' knowledge of non-profit organizations, they recommended that UNDP maintain the equivalent of between 6 and 12 months' expenditures as liquidity to meet inevitable fluctuations in cash flows. This benchmark was based on what is considered prudent financial management, particularly for organizations without borrowing capacity. The consulting firm asserted that in the non-profit sector, this level of liquidity is considered to be an indication of financial stability.

20. The assessment of UNDP financial risk also benefited from an exercise conducted in 1997 by the United Nations Office for Project Services (UNOPS) and presented to the Executive Board at its third regular session 1997 (DP/1997/26). The UNOPS study assessed risks faced by the organization and identified four possible responses for addressing risk: limitation; management; transference; or assumption. The study defined a new UNOPS reserve formula based on 4 per cent of the combined administrative and project budget expenditures of the prior year. UNDP followed the UNOPS approach to an assessment of risk based on the four possible responses identified. While recognizing that UNDP faces risks in its operations that are different from those faced by UNOPS, the ability to limit, manage or transfer risk all reduce the chance that UNDP will be required to assume financial loss and draw upon reserves.

21. Taking into consideration the above reviews, the following paragraphs contain an analysis of the most significant financial risks faced by UNDP. Risks associated with Regular resources activities and Other resources activities are presented separately within each category.

## A. Income-related risks

22. The most significant financial risks faced by UNDP are income related. Unpredictable fluctuations in contributions pledged from year to year, their value in United States dollar terms in light of exchange rate volatility, and unknown timing of payments of contributions constitute the main risk elements. These risks are further enhanced by the concentration of contributions from a relatively limited number of large donors. For example, the top five donors to UNDP regular resources accounted for some 51 per cent of voluntary contributions over the years 1991-1996.

23. Income-related risks in Other resources activities are substantially mitigated by UNDP Financial Regulations, particularly Regulation 4.15(a), which specifies that all contributions are to be paid in advance of the implementation of planned activities. Some risk remains, however, as donors are often unwilling to advance 100 per cent of a commitment, preferring to effect payment in instalments matched to project budgets and cash requirements. Such practices expose UNDP to a risk of delayed or defaulted payment over the course of project activities.

## B. Expenditure-related risks

24. For both Regular resource and Other resource activities, there are a number of risks that are present when making commitments for expenditures. These can occur in resource planning, in the form of over-allocation of resources, or in programme delivery in the form of mismanagement or overexpenditure of allocated resources. Financial risks also arise when making disbursements and include the risks of overpayment, payment to the wrong vendor, fraud or vendor bankruptcy prior to completion or delivery. These risks are present whether UNDP directly manages the activity or is using an agent. In addition, UNDP makes advances for programme and project execution to executing agents and to Governments under national execution. The possibility of fraud or loss exists if an advance is not used for the purpose intended and cannot be recovered. While these risks can be minimized through appropriate internal controls and staff training, they cannot be completely eliminated. With the goal of further minimizing risk, UNDP is reviewing its controls and is implementing an improved expenditure control policy.

## C. Asset-related risks

25. UNDP cash and investments assets are also subject to risks. Guidelines are in place that substantially reduce the probability of risk of loss from investment activities by controlling types of investments, minimum credit ratings and exposures to counterparts, etc. In addition, cash management

policies and procedures in place in country offices significantly mitigate the risk of loss from theft or devaluation. Illiquid assets, such as property and equipment, are protected under general property insurance coverage policies. Cash in transit is also protected under a commercial insurance policy.

### D. Liability-related risks

26. UNDP is exposed to liabilities from contractual agreements or third parties. Risk exposure in this area is difficult to quantify, but encompasses a variety of legal agreements entered into with donors, Governments, non-governmental organizations, executing agencies and individuals. Costs to UNDP could arise from legal expenses and from management time diverted from other activities to handle problem situations. A number of staff-related liabilities associated with entitlements also exist for which future required funding is not known and may be significant. Examples include post-retirement medical benefits and pension liabilities.

### E. Structural risks

27. A category of risk to which UNDP is exposed is similar to one identified by UNOPS: the risk created by business interruption. This risk is magnified by the global structure of UNDP since the size of the country office network increases the chance that there may be civil strife or unrest somewhere in the world that could negatively impact UNDP operations. Similarly, if UNDP were to have its activities interrupted owing to a catastrophic event (e.g., as a result of a major information systems failure), there would be significant costs associated with restoring normal operations.

## V. APPLICATION OF FINANCIAL MANAGEMENT CONCEPTS

28. The present chapter defines the basis on which the concepts of liquidity, working capital and reserves should be applied. The application is linked to the financial risk assessment that was performed and to what is considered prudent financial management. Formulas have been reviewed accordingly and are presented below.

### A. Reserves

29. UNDP has developed a simplified approach to the calculation of reserves be performed annually based on historical data. A three-year average is recommended for most calculations since that period is the same as the UNDP planning horizon. It should be noted that this represents a change from the current methodology, which is based on estimates rather than on actual data. The Administrator believes that the use of a three-year historical period also provides more perspective on trends and greater objectivity than a forecast.

## B. Formula for the Operational Reserve

30. Based on the risk elements presented in chapter IV of the present report, the Administrator recommends that the formula for the calculation of the Operational Reserve be amended in accordance with the following assessment.

### Income-related risks

31. In order to protect UNDP from the risk of unexpected downward fluctuations in voluntary contributions, a component of the Operational Reserve is to be calculated as the equivalent of 10 per cent of the average of the voluntary contributions received over the most recent three years, rounded to the nearest $1 million. In 1998, the amount would be $84 million, calculated as follows:

Voluntary contributions received

(Millions of dollars)

| | | |
|---|---|---|
| 1997 | 761 | |
| 1996 | 848 | |
| 1995 | 900 | |
| Average | | 836 |
| 10 per cent of which | | 84 |

The recommendation to use a factor of 10 per cent stems from the study undertaken by the international consultants, which identified the average fluctuation in contributions pledged over a number of years to be 5.8 per cent, and the average fluctuation in exchange rates against the United States dollar over the same period to be 3.7 per cent. Thus, 10 per cent is believed to be a reasonable percentage to set as a reserve against income risks for voluntary contributions.

### Expenditure-related risks

32. As a protection against the risks associated with expenditure, a second component of the Operational Reserve would be determined by taking 2 per cent of the average of total expenditures of the three prior years, rounded to the nearest $1 million. The use of a 2 per cent rate is based on UNDP Financial Rule 110.1, which allows for expenditure against project budgets to be exceeded by $20,000 or 4 per cent, whichever is higher, but not more than 2 per cent of the total of an executing agency's total allocations. While this rule does not directly relate to biennial budget expenditure, it is prudent to include administrative expenditure as well. On this basis, this component of the Operational Reserve would amount to $17 million, calculated as follows:

| | Expenditures (Millions of dollars) | |
|---|---|---|
| 1997 | 961 | |
| 1996 | 847 | |
| 1995 | 801 | |
| Three-year average | | 870 |
| Two per cent reserve | | 17 |

Liability-related and structural risks

33. The unknown and unpredictable costs associated with such risks as contractual disputes, unfunded liabilities, business interruption or losses due to civil strife, natural disasters, etc., make it difficult to use a strict formula to determine the protection needed. A lump sum amount for this component of the reserve is necessary. The Administrator recommends that this amount be established as 25 per cent of the sum of the income and expenditure components of the Operational Reserve, rounded to the nearest $1 million. In this way, liability and structural risk protection will be proportional to the growth of the UNDP programme. On this basis, the component relating to liability and structural risks would amount to $25 million, calculated as follows:

| | Millions of dollars |
|---|---|
| Income component of the Reserve | 84 |
| Expenditure component of the Reserve | 17 |
| Total of these components | 101 |
| 25 per cent thereof | 25 |

Cash-flow risks

34. Historically, UNDP has experienced significant gaps in its cash flow each year resulting from the mismatch between cash outflow for programme and administrative expenditure and cash inflow from voluntary contributions. While cash outflows have tended to be spread evenly throughout the year, the rate of receipt of voluntary contributions have tended to be more and more towards the end of the calendar year. As UNDP does not have the authority to borrow funds to meet such seasonal cash flow variations, when such variations leave the organization with a temporary need for cash in order to meet its normal obligations, it will have to make use of the Operational Reserve for that purpose.

35. Based on an analysis of the monthly cash flow position of UNDP over a five-year period, which reveals that gaps of up to 15 per cent between cash inflows and outflows have existed at various points of time, the Administrator believes that a component of the Operational Reserve equal to the cash requirements for one month should be maintained. Given the critical nature of this element of the Reserve, it would be appropriate to calculate the amount on the basis of the most recent full-year expenditure. As 1997 total expenditure for regular resources amounted to $961 million, the one-month equivalent would be $80 million.

36. Under the Administrator's proposed revised formula, the Operational Reserve would equal $206 million in 1998, an increase of $26 million from the $180 million calculated by the current formula (see table 1).

Utilization of the Operational Reserve

37. In accordance with Financial Regulation 12.2, the Administrator will decide as to the need to draw upon the resources of the Operational Reserve. The Administrator will report all such drawdowns to the Executive Board at the subsequent regular session, or between sessions to the members of the Board whenever in the Administrator's opinion, the situation so merits. When notifying the Board of the utilization of Operational Reserve resources, the Administrator will at the same time advise the Board as to the timing and means by which the Operational Reserve will be replenished.

38. The Administrator intends to make use of the resources of the Operational Reserve to minimize the negative effects on programme delivery resulting from any occurrence of the financial risks covered by the Operational Reserve. Drawdowns of resources from the Operational Reserve will be undertaken only when the level of available regular resources has been depleted, and will be effected by a transfer of resources from the Operational Reserve to the regular resources of UNDP, and recorded as such in the financial statements.

## C. Formula for the Other resources reserve

39. In accordance with the UNDP Financial Regulations and Rules, Other resources activities are required to be fully funded, meaning that funds must be received in advance of the implementation of planned activities. Therefore, many of the income-related risks associated with Regular resource activities do not apply to Other resource activities. Nevertheless, expenditure-related risks, structural risks, and, to a certain extent, liability risks do exist and prudent financial management suggests that such risks be protected through a financial reserve.

Expenditure-related risks

40. The Administrator recommends that a component of reserve for expenditure-related risks be determined by taking 2 per cent of the average of total expenditures of the three previous years incurred under cost-sharing and trust fund activities, rounded to the nearest $1 million. The use of a 2 per cent rate matches that used for the expenditure-related component of the

proposed formula for the Operational Reserve for Regular resource activities. As an example, if the formula were applied for 1998, the amount of this component would be $19 million, calculated as follows:

| Year | Expenditure (Millions of dollars) | |
|---|---|---|
| 1997 | 1 139 | |
| 1996 | 925 | |
| 1995 | 733 | |
| Three-year average | | 932 |
| Two per cent reserve | | 19 |

Liability and structural risks

41. Under Other resources, liability-related risks are associated with risks arising from fraud, mismanagement, or poor management of resources held in a fiduciary capacity, and which could therefore result in a claim against UNDP. Structural risks arise from the administrative costs associated with programme activities financed by other resources. Staffing and other administrative costs, such as office accommodation, are financed from the administrative support costs charged to cost-sharing and trust-fund arrangements, and recorded as extrabudgetary income. Should this earned income be disrupted, or even cease owing to circumstances beyond the control of UNDP, significant administrative expenditures would still need to be incurred to meet ongoing obligations.

42. In order to ensure that administrative obligations could be met in a worst-case scenario without utilizing UNDP regular resources, the Administrator believes that funds sufficient to cover such costs for a period of one year would be needed. This amount is currently estimated at $30 million.

43. To cover fully the expenditure, liability, and structural risks described above, the Other Resources Reserve would amount to $49 million for the 1998 financial situation resulting from:

| | Millions of dollars |
|---|---|
| Expenditure component | 19 |
| Liability and structural component | 30 |
| Total | 49 |

Funding and utilization of the Other Resources Reserve

44. In recognition of the risks relating to the acceptance and management of Other resources by UNDP in those countries in which they have been largely generated, the Administrator has been informally reserving a portion of the extrabudgetary income derived from the fees charged by UNDP. The Administrator now intends to record as a reserve those funds previously reserved for this purpose.

45. The Bureau for Programme and Resources Management (BPRM), is currently reviewing the UNDP cost-recovery policies and mechanisms, including the fee structure. This review will also take into account the need for a reserve for the risks relating to other resources.

## D. Formula for liquidity

46. As previously stated, liquidity is defined as the total amount of cash and investments held at any point in time, and may also be expressed as the sum of reserves and working capital. In its assessment of UNDP financial risks, the international consulting firm engaged by the Administrator advised that organizations such as UNDP, which do not have access to the capital markets nor the ability to borrow from banks to cover periodic cash flow needs, should maintain in liquidity the equivalent of 6 to 12 months' expenditure as a prudent level. Based on that assessment, the Administrator believes that UNDP should manage its liquidity to fall within such a range. It is to be noted that (a) the level of liquidity held by UNDP is largely a factor of the timing of the payment of voluntary contributions and (b) the organization must have a sufficient level of working capital to operate effectively. UNDP expends approximately $80 million per month, and should cash resources start to dwindle, the Administrator must have sufficient time to initiate corrective action.

47. The Administrator wishes to emphasize that the indicative amount of liquidity to be held is not intended to be a mandated amount. Liquidity levels will indeed fluctuate for a variety of reasons, many of which may be seasonal in nature. However, if the liquidity level rises above or falls below the indicative range, it is a signal for UNDP to take action. For example, if liquidity falls below the equivalent of four months' expenditure, and if the reasons for the reduced liquidity level warrant it, the Administrator may initiate withdrawal action to accelerate the payment of contributions. Similarly, a rising liquidity level may signal programme delivery problems, which may require remedial actions regarding programming or programme execution.

48. In 1997, programme and administrative expenditures totalled $960 million. Therefore, the indicative liquidity range for 1998 would be from $480 million to $960 million. Liquidity minus reserves represents the working capital available to support the organization's operations. For example, a liquidity of $480 million, less reserves of $206 million calculated under the proposed formula for the Operational Reserve, would leave approximately $274 million of working capital, which is currently approximately 3.5 months of cash outflows. At the time of the preparation of the present report, the actual regular resources liquidity of UNDP amounted to approximately $447 million, or roughly five and

one half months' needs, of which $206 million, or three months' needs, reflects the working capital.

49. It is important to note the distinction between liquidity and the balance of unexpended resources. In document DP/1998/34, the Administrator has projected that the balance of unexpended UNDP resources available for programming would fall to zero by the end of 1999. In such an event, UNDP would nevertheless have a positive level of liquidity, probably at the low end of the range (six months), since it would still have funds of the non-programmable operational reserve, and some amount of working capital relating to undisbursed expenditure.

50. Other resources liquidity. In 1997, Other resources expenditures totalled $1.1 billion. Therefore, the recommended liquidity range for Other resources is from $550 million to $1.1 billion. As noted above, liquidity minus reserves represents the working capital available to support the organization's operations. Liquidity of $550 million, less proposed reserves of $49 million for the Reserve for Other resources, would leave $501 million of working capital. Since fully funded activities by definition require funds to be received prior to commitment, a higher level of working capital should be expected. Indeed, at the time of preparation of the present report, Other resources liquidity amounted to approximately $950 million, or some 9.0 months' of cash flow needs after applying the proposed reserve of $49 million.

51. Liquidity of funds administered by UNDP. The Administrator considers that the concept of maintaining a liquidity range is equally valid for each UNDP-administered fund and should be applied to them individually. The present report does not include an assessment of the risks for funds administered by UNDP. This exercise should be conducted in the future and should take into account the level of liquidity and the reserves deemed necessary for the risks of each particular fund. Some of the funds administered by UNDP have already established contingency reserve levels (e.g., the United Nations Development Fund for Women, the United Nations Capital Development Fund).

52. The application of the formula proposed by UNDP is summarized in tables 1 and 2. The calculation uses 1995 to 1997 financial variables applied in the 1998 context.

Table 1. Summary of components of liquidity - Regular resources, 1998

| | | 6 months | 12 months |
|---|---|---|---|
| | | (Millions of dollars) | |
| Liquidity range (6-12 months of programme and administrative expenditures) | | 480 | 960 |
| of which: | | | |
| Operational Reserve - | | | |
| Income component | 84 | | |
| Expenditure component | 17 | | |
| Miscellaneous component | 25 | | |
| Cash-flow component | 80 | 206 | 206 |
| Working capital range | | 274 | 754 |

Table 2. Summary of components of liquidity - Other resources, 1998

| | | 6 months | 12 months |
|---|---|---|---|
| | | (Millions of dollars) | |
| Liquidity range (6-12 months of expenditure) | | 550 | 1 100 |
| of which: | | | |
| Reserve - | | | |
| Expenditure component | 19 | | |
| Liability and structural component | 30 | 49 | 49 |
| Working capital range | | 501 | 1 051 |

## VI. RECOMMENDED LIQUIDITY, WORKING CAPITAL AND RESERVE LEVELS

53. Based on the foregoing discussion and analysis, the Administrator advises the Executive Board that:

(a) A broad basis for liquidity holdings is an amount equal to between 6 and 12 months of annual expenditure;

(b) Liquidity is defined as the sum of working capital and reserves.

54. The Administrator recommends that:

(a) Liquid assets be set aside for the Operational Reserve based on the formula described in chapter IV. The use of that formula would have set the level of the Operational Reserve at $206 million for 1998.

(b) A reserve for Other resources activities be established based on the formula described in chapter IV and funded through a transfer from the extrabudgetary account in accordance with an appropriate cost-recovery modality. For 1998, the Other Resources Reserve would have been set at $49 million.

## VII. EXECUTIVE BOARD ACTION

55. The Executive Board may wish to:

(a) Take note of the report of the Administrator;

(b) Note approach recommended by the Administrator to determine UNDP liquidity;

(c) Support the recommendation of the Administrator for the establishment of a reserve for Other resources activities and the mechanism for its funding;

(d) Note the recommended formula for the calculation of the Operational Reserve and the intention of UNDP to include it in the Financial Rules.

## Notes

[1] Official Records of the Economic and Social Council, Forty-ninth Session, Supplement No. 6A (E/4884/Rev.1), page 39.

[2] Ibid., Sixth-first Session, Supplement No. 2A (E/5846/Rev.1), page 22.

---